

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



In the Matter of the Application of Southern California Gas Company (U904G), San Diego Gas & Electric Company (U902M) and Southern California Edison Company (U338E) for Approval of Changes to Natural Gas Operations and Service Offerings.

A.06-08-026

NOTICE OF EX PARTE COMMUNICATION

In accordance with Rule 8.3 of the Commission's Rules of Practice and Procedure, Southern California Gas Company ("SoCalGas") and San Diego Gas & Electric Company ("SDG&E") file notice of *ex parte* communication occurring on March 6, 2008.

I.

On Thursday, March 6, 2008, Lad Lorenz, Vice President of Regulatory Affairs for SoCalGas and SDG&E, and Pedro Villegas, Manager of Regulatory Relations for SoCalGas and SDG&E, met with Lindsay Brown and Robert Kinosian, advisors to Commissioner Roger Bohn. The meeting occurred at 1:00 p.m. at the San Francisco offices of the Commission and lasted approximately 30 minutes. Communications were verbal and written. A copy of SoCalGas' Petition for Modification of D.07-12-019 (the "PFM") was subsequently provided to Ms. Brown and Mr. Kinosian.

II.

Mr. Lorenz and Mr. Villegas requested the meeting to discuss SoCalGas' PFM of D.07-12-019 and issues relating to the unbundled storage program that comprise part of the 2009 Biennial Cost Allocation Proceeding application (BCAP) of SoCalGas and SDG&E (A.08-02-001). Mr. Lorenz and Mr. Villegas stated that the Commission should approve the PFM to eliminate memorandum account treatment for unbundled storage revenues until the next BCAP decision and return the SoCalGas unbundled storage program to the 50/50 shareholder/ratepayer sharing of risk and reward established in the 1999 BCAP.

Mr. Lorenz provided a brief history of SoCalGas' unbundled storage program. Mr. Lorenz and Mr. Villegas stated that the establishment of memorandum account treatment for unbundled storage revenues per D.07-12-019 has created regulatory uncertainty affecting decision-making on the current operations and future planning of SoCalGas' storage program. The uncertain disposition of storage net revenues sequestered in the memorandum account fails to provide a basis for prudent evaluation of ongoing and future SoCalGas investments that are designed to maximize the availability of storage to the marketplace and that generate revenues that equally benefit ratepayers and shareholders.

Mr. Lorenz added that the effects of regulatory uncertainty could persist well into 2009 unless the Commission acts on the PFM or expedites treatment of unbundled storage issues in the 2009 BCAP.

Mr. Villegas disagreed with the Division of Ratepayer Advocates' assertion that "The BCAP memorandum account simply allows the Commission to reconsider the noncore storage revenue sharing mechanism faced with a clean slate and full record developed in the BCAP." Mr. Villegas asserted that the memorandum account is unwarranted and unnecessary, as the Commission can easily consider changes to the revenue-sharing arrangement for unbundled storage program in the 2009 BCAP in the absence of a memorandum account.

To request a copy of this notice, please contact:

Trish Rickard
601 Van Ness Avenue, Suite 2060
San Francisco, CA 94102
Telephone: (415) 202-9986
Facsimile: (415) 346-3630
Email: Trickard@semprautilities.com

Respectfully submitted,

/s/ Pedro Villegas

Pedro Villegas, Manager of Regulatory Relations
Southern California Gas Company and
San Diego Gas and Electric Company
601 Van Ness Avenue, Suite 2060
San Francisco, CA 94102

Date: March 11, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern)
California Gas Company (U 904 G), San Diego)
Gas & Electric Company (U 902 M) and Southern)
California Edison Company (U 338 E) for)
Approval of Changes to Natural Gas Operations)
and Service Offerings.)

A.06-08-026
(Filed August 28, 2006)

**PETITION OF SOUTHERN CALIFORNIA GAS COMPANY AND SAN DIEGO GAS &
ELECTRIC COMPANY FOR MODIFICATION OF DECISION NO. 07-12-019**

MICHAEL R. THORP

Attorney for
SOUTHERN CALIFORNIA GAS COMPANY and
SAN DIEGO GAS & ELECTRIC COMPANY
555 West Fifth Street, Suite 1400
Los Angeles, California 90013-1011
Telephone: (213) 244-2981
Facsimile: (213) 629-9620
E-mail: mthorp@sempra.com

January 9, 2008

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A.06-08-026
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**PETITION OF SOUTHERN CALIFORNIA GAS COMPANY AND SAN DIEGO GAS &
ELECTRIC COMPANY FOR MODIFICATION OF DECISION NO. 07-12-019**

I. INTRODUCTION

Pursuant to Rule 47 of the Commission's Rules of Practice and Procedure, Southern California Gas Company ("SoCalGas") and San Diego Gas & Electric Company ("SDG&E") hereby request that the Commission modify Decision No. 07-12-019 to eliminate the memorandum account treatment for unbundled storage revenues until the next BCAP decision, and at least temporarily return SoCalGas' unbundled storage program to the 50/50 sharing of risk and reward established in the last BCAP. These limited modifications will eliminate an unjustified penalty imposed on SoCalGas simply because it agreed to settle its energy crisis differences with Edison with a settlement that proposed ratepayer-friendly changes to the status quo for unbundled storage. Furthermore, this modification will enable SoCalGas to continue to provide unbundled storage services and engage in storage expansion activities over the next 12-18 months without the risk that all of its efforts will result in no earnings whatsoever for shareholders.

II. BACKGROUND

The joint application by SoCalGas, SDG&E, and Southern California Edison Company ("Edison") that forms the basis for this proceeding sought approval to implement a number of

changes to the operations and service offerings of SoCalGas and SDG&E. These proposed changes were in turn the result of the January 2006 Continental Forge Settlement and a May 2006 settlement between SoCalGas, SDG&E, and Edison. In D.07-12-019, the Commission adopted many of the changes proposed by applicants, declined to adopt others, and deferred certain proposals by applicants to the upcoming SoCalGas BCAP proceeding. This petition relates to one of the proposed changes presented by applicants that has been deferred to the BCAP proceeding for further consideration – a new proposed annual \$20 million cap on shareholder earnings from unbundled storage operations.

For many years prior to D.07-12-019, earnings from SoCalGas' unbundled storage operations have been shared 50/50 between customers and shareholders, with no cap on the amount of earnings shareholders could receive.¹ SoCalGas, SDG&E, and Edison proposed to change this status quo with a new \$20 million annual cap on shareholder earnings from unbundled storage revenues. Applicants believe this new \$20 million annual cap is a reasonable and appropriate change to SoCalGas' product and service offerings. The cap is sized to prevent SoCalGas from receiving a windfall when the market value of storage products is high, while still providing SoCalGas with the proper incentives to aggressively promote unbundled storage products and seek out storage expansion opportunities.

In D.07-12-019, the Commission declined to adopt this particular proposal by Applicants, noting that “a cap as high as \$20 million has not been justified as being necessary to provide utility incentives to market unbundled storage.”² Instead, the Commission deferred the adoption “of any explicit revenue cap or percentage allocation applicable unbundled storage

¹ The 50/50 sharing of risk and rewards from unbundled storage was adopted in the SoCalGas 1999 BCAP decision, D.00-04-060.

² D.07-12-019, mimeo., at 75.

revenue to the BCAP.”³ At the same time, the Commission directed that unbundled storage revenues receive memorandum account treatment until a decision in the upcoming BCAP proceeding:

On an interim basis between the effective date of this decision and a decision in the BCAP proceeding, we hereby direct that all noncore storage costs and revenues be recorded in a memorandum account. Based upon further analysis in the upcoming BCAP as to the appropriate shareholder percentage allocation and cap for unbundled storage revenues, the revenues recorded in the BCAP memorandum account shall be allocated between shareholders and ratepayers.

With this approach, the Commission will preserve the option to apply any adopted findings in the upcoming BCAP to revenues booked into the memorandum account from the effective date of this decision going forward. Thus, any potential for ratepayer inequities resulting from an excessive shareholder allocation or revenue cap will be avoided. Likewise, the opportunity will be preserved to determine the appropriate shareholder allocation and cap to provide an adequate incentive to market unbundled storage and increase unbundled storage capacity consistent with the realities of the current market conditions. With this disposition, any potential for inequities resulting from an improper allocation of noncore storage revenues will be avoided, while additional time will be provided to develop a more complete record as a basis to determine the appropriate revenue sharing allocation formula and shareholder earnings cap to be applied on a longer-term basis in the upcoming BCAP.⁴

SoCalGas and SDG&E do not object to the Commission deferring consideration of applicants’ proposed new \$20 million annual cap on shareholder earnings from unbundled storage revenues until the upcoming BCAP proceeding. Likewise, SoCalGas and SDG&E understand that one of the many issues to be considered in the upcoming BCAP is whether the 50/50 sharing of unbundled storage revenues adopted by the Commission in D.00-04-060 should

³ D.07-12-019, mimeo., at 76.

⁴ D.07-12-019, mimeo., at 76-77.

continue. But memorandum account treatment of unbundled storage revenues until a BCAP decision is neither justified nor fair. For the reasons set forth below, this limited aspect D.07-12-019 should be revised, and SoCalGas' unbundled storage program should be returned to the status quo that existed prior to the issuance of D.07-12-019 last month.

III. MEMORANDUM ACCOUNT TREATMENT FOR UNBUNDLED STORAGE REVENUES UNFAIRLY PUNISHES SOCALGAS FOR SETTLING WITH EDISON

Memorandum account treatment for unbundled storage revenues eliminates any shareholder earnings from the sale of unbundled storage products and future storage expansions for a significant period of time. This equates to 2008 earnings loss of up to \$20 million, assuming adoption of the new annual cap proposed by applicants, or even more under the cap-less status quo that existed prior to D.07-12-019. Moreover, given that a BCAP decision and implementation of BCAP-related tariffs will likely not take place until some time in 2009 (or perhaps even later, in the case of tariff implementation), the earnings shortfalls created by memorandum account treatment could be substantially greater, especially if months in 2009 with no shareholder earnings from unbundled storage are not somehow offset later that same year.

What has SoCalGas done to merit a potential earnings loss of more than \$20 million over the next 12-18 months? Nothing more than settle our longstanding differences with Edison relating to the 2000-2001 energy crisis, and jointly propose a new customer-friendly \$20 million annual shareholder earnings cap. Simply put, such punishment does not fit the "crime." SoCalGas and SDG&E understand the Commission's desire to gather additional information before deciding upon a cap on shareholder earnings from unbundled storage. SoCalGas and SDG&E also understand that the Commission may wish to reconsider in the upcoming BCAP the 50/50 sharing of risk and reward for unbundled storage established in the

last BCAP. But we cannot understand a mid-BCAP abdication of the sharing of risk and reward that has served the utilities and their customers very well over the past seven years – especially since the new \$20 million annual shareholder earnings cap on unbundled storage revenues proposed by SoCalGas, SDG&E, and Edison is the only real precipitating factor for such a change.

Would this dramatic intra-BCAP penalty have been imposed in the absence of our settlement with Edison and the resulting application in this proceeding? We think not. Would this \$1.7 million/month-plus penalty have been imposed nearly as quickly if SoCalGas, SDG&E, and Edison hadn't pushed for a quick omnibus decision and fast adoption of the numerous Continental Forge and Edison settlement provisions – provisions that will provide substantial benefits to our customers and the marketplace? Obviously, no. The Commission should keep in mind that applicants have not asked to increase an existing unbundled storage cap or otherwise increase shareholder earnings. Under such circumstances, the financial penalty and uncertainty created by interim memorandum account treatment for storage revenues is both unreasonable and unfair.

Financially, SoCalGas and SDG&E would have been much better off not settling our differences with Edison. Instead, we should have continued with the longstanding Border OII litigation, and fought to have the Commission finally take a look at the conduct of companies other than Sempra and its utility subsidiaries during the 2000-2001 energy crisis. If we had not settled with Edison, the Commission likely would not have seriously considered changes to SoCalGas' unbundled storage program until the next BCAP. The downside in additional litigation costs and further lost time we would have faced from additional litigation with Edison is miniscule compared to the potential \$20 million + hit shareholders will take over the next 12-18 months if the memorandum account treatment established by D.07-12-019 stands. Utilities

regulated by the Commission should be encouraged to resolve long-standing and divisive differences, not penalized for doing so.

During the December 6, 2007 business meeting during which the Commission adopted D.07-12-019, President Peevey stated that “I hope applicants realize that the memorandum account is not something to be feared.”⁵ Yet, how else can we feel? President Peevey’s words, no matter how well-intentioned, offer cold comfort to a financial community that sees nothing but an earnings shortfall created by an application that did not propose changing the sharing of risk and reward for unbundled storage. Moreover, the tremendous risk and uncertainty created by memorandum account treatment for unbundled storage revenues is very real for SoCalGas.

Finally, memorandum account treatment would harm customers as well as utility shareholders, since unbundled storage revenues that would otherwise be flowing through to customer rates will now be sitting in a memorandum account awaiting BCAP tariff implementation. There is simply no need to penalize shareholders, customers, or anyone else under these particular circumstances. The Commission should eliminate memorandum account treatment for SoCalGas’ unbundled storage revenues, and simply return to the 50/50 risk and reward status quo until the various pending unbundled storage issues noted in D.07-12-019 can be fully and thoughtfully explored in the upcoming BCAP proceeding.

IV. MEMORANDUM ACCOUNT TREATMENT FOR UNBUNDLED STORAGE WOULD REQUIRE THE COMMISSION TO INAPPROPRIATELY ESTABLISH A RISK/REWARD RELATIONSHIP AFTER THE FACT

The memorandum account treatment for unbundled storage revenues adopted in D.07-12-019 “will preserve the option to apply any adopted findings in the upcoming BCAP to revenues booked into the memorandum account from the effective date of this decision going

⁵ Transcript of the Commission’s December 6, 2007 business meeting; Item 32 at p. 2.

forward.”⁶ This hindsight approach to establishment of a risk/reward relationship represents misguided, inappropriate regulatory policy.

The Commission generally puts utilities at risk and offers them rewards for successful behaviors in order to advance customer and social interests – whether that interest is the safe, reliable acquisition of low-cost gas supplies, attainment of energy efficiency goals, or successful marketing and development of unbundled storage assets. The quintessence of each of these risk/reward relationships is self-interest – i.e., the well-proven concept that utilities will perform better at certain functions if their own self-interest is aligned with that of customers and/or society in general. But a motivational risk/reward relationship is utterly meaningless if established after the relevant utility actions have taken place and the risks in question have either materialized, or not.

Put another way, if storage values plummet over the next 12-18 months and SoCalGas loses money on the unbundled storage program (as it did in 2000), would it be fair for the Commission to saddle SoCalGas with 50 percent of the losses because the risk/reward relationship for unbundled storage was 50/50 before suspended by D.07-12-019? To saddle SoCalGas with 100 percent of the losses in the event the Commission decides to change SoCalGas’ unbundled storage program to 100 percent risk/reward to mirror PG&E’s unbundled storage program? To give SoCalGas’ shareholders 100 percent of the 2008 and 2009 revenues from a successful unbundled storage program in such an event? To give shareholders nothing, or next to it, because storage values remained high during 2008 and 2009 and none of the big risks faced by providers of unbundled storage services actually materialized? Under the after-the-fact unbundled storage regime established by D.07-12-019, all of these results are plausible and can

⁶ D.07-12-019, mimeo., at 76.

be argued with some level of conviction. Simply put, this is no way to establish sound regulatory policy.

SoCalGas' unbundled storage program over the last seven years has become an unqualified success, at least in part because of the prescient 50/50 risk/reward relationship established by the Commission in D.00-04-060. There is simply no good reason to shelve that successful risk/reward relationship for the next two years in favor of uncertainty and some sort of after-the-fact divvying up of unbundled storage revenues that will likely depend more on argumentative skills and lobbying acumen than the respective risks actually assumed over that time period by SoCalGas and its customers. The old unbundled storage risk/reward relationship isn't broken; the Commission certainly shouldn't "fix" it with an uncertain process that doesn't really make any sense.

V. THERE IS NO SUBSTANTIVE BASIS FOR ALTERING THE 50/50 RISK/REWARD UNBUNDLED STORAGE RELATIONSHIP ESTABLISHED BY THE COMMISSION IN D.00-04-060 AT THIS TIME

In D.07-12-019, the Commission presents only two arguments for establishing an unbundled storage memorandum account and potentially changing the 50/50 unbundled risk/reward relationship it established in D.00-04-060 – SCGC's claim that customers have only received \$6 million of unbundled storage revenues since the last BCAP, with shareholders pocketing the remaining \$89 million, and DRA's assertion that storage prices and revenues have risen to "unforeseen levels" since 2000.⁷ Neither of these arguments justifies establishment of a memorandum account and a change to the 50/50 risk/reward status quo for SoCalGas unbundled storage revenues.

⁷ D.07-12-019, mimeo., at 72-73.

As the Commission explicitly determined in D.07-12-019, SCGC's misleading customer/shareholder figures are premised upon an assumption the Commission has already soundly rejected – i.e., that the LRMC scalar should supposedly be allocated to the unbundled storage program:

SCGC's proposed allocation for unbundled storage revenues is predicated on the assumption that the LRMC scalar is fully allocated to the at-risk unbundled storage program. The Commission, however, rejected that approach in the 1999 BCAP proceeding, and instead, applied unscaled marginal costs for purposes of allocating risk to shareholders.⁸

Accordingly, SCGC's "\$89 million of unbundled storage revenues to shareholders and only \$6 million to customers" argument is false, and cannot form a reasonable basis for establishing an unbundled storage memorandum account or changing the 50/50 risk/reward relationship established in D.00-04-060. Since 2000, customers have indeed been receiving 50 percent of all unbundled storage revenues, and will continue to do so under the status quo.

Likewise, DRA's assertion that storage prices and revenues have risen to unforeseen levels since 2000 does not form a rational foundation for an unbundled storage memorandum account. Yes, storage prices and revenues have risen since 2000 – that is the primary reason for the \$20 million annual shareholder earnings cap proposed by applicants. But nothing in D.00-04-060 indicates that the Commission failed to consider the possibility that storage prices and revenues could rise substantially over the BCAP period, or that some sort of intra-BCAP adjustment would be necessary if such increases indeed took place.

Rather, the Commission established a straightforward risk sharing mechanism that gave SoCalGas a strong, unequivocal incentive to market and develop storage assets and thereby lower customer rates and avoid stranded storage capacity. If SoCalGas had not been

⁸ D.07-12-019, mimeo., at 104-05 (Finding of Fact No. 36).

successful marketing and developing storage assets under the mechanism, it and its customers would have paid the price. Now that SoCalGas has been successful, it should be allowed to enjoy the fruits of its efforts. Success deserves to be rewarded, not penalized. If future fine-tuning of unbundled storage risk/reward mechanism is necessary, the BCAP is the place for such fine-tuning, and in the spirit of fairness, any adjustments must be prospective only.

VI. MEMORANDUM ACCOUNT TREATMENT FOR UNBUNDLED STORAGE REVENUES WOULD EFFECTIVELY HALT STORAGE EXPANSION ACTIVITIES UNTIL BCAP TARIFF IMPLEMENTATION

If the unbundled storage memorandum account treatment established by D.07-12-019 stands, SoCalGas has little incentive to actively promote existing storage products until the next BCAP is implemented, and no incentive whatsoever to pursue any additional storage expansions. Any additional dollars we would potentially spend on expansions would be better spent on other programs in which SoCalGas has a more certain prospect of shareholder reward – or at least knows that it isn't actually decreasing shareholder earnings by spending more to achieve exactly the same level of shareholder reward.

Our existing unbundled storage incentives have helped create a strong and vibrant unbundled storage program in Southern California, and led directly to expansions of SoCalGas' storage inventory capacity from 105 Bcf to 131 Bcf over the last several years. It makes absolutely no sense to destroy this formula for success, even on an interim basis, and bring storage development activity in Southern California to an abrupt halt.

VII. CONCLUSION

For the foregoing reasons, SoCalGas and SDG&E request that the Commission modify D.07-12-019 in the limited manner proposed herein. Memorandum account treatment of unbundled storage revenues until a BCAP decision should be eliminated, and SoCalGas' unbundled storage program should be returned, at least temporarily, to the 50/50 sharing of risk

and reward that existed prior to the issuance of D.07-12-019. The Commission's decision in the upcoming BCAP proceeding may very well change the 50/50 sharing of unbundled storage risks and revenues that has existed since early 2000, but that change should be prospective only.

To make these limited modifications, Finding of Fact No. 35 should be eliminated, together with the last two paragraphs of text in Section 7.2.2, and the words "50/50 ratepayer/shareholder revenue allocation with" should be deleted from Ordering Paragraph No. 19.

Respectfully submitted,

By: /s/ Michael R. Thorp
Michael R. Thorp

Attorney for

SOUTHERN CALIFORNIA GAS COMPANY and
SAN DIEGO GAS & ELECTRIC COMPANY
555 West Fifth Street, Suite 1400
Los Angeles, California 90013-1011
Telephone: (213) 244-2981
Facsimile: (213) 629-9620
E-mail: mthorp@sempra.com

January 9, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing **PETITION OF SOUTHERN CALIFORNIA GAS COMPANY AND SAN DIEGO GAS & ELECTRIC COMPANY FOR MODIFICATION OF DECISION NO. 07-12-019** on all parties of record in this proceeding by electronic mail, and by Federal Express to ALJ Pulsifer.

Dated at Los Angeles, California, this 9th day of January 2008.

/s/ Rose Mary Ruiz

Rose Mary Ruiz

CALIFORNIA PUBLIC UTILITIES COMMISSION

Service Lists - Proceeding: A0608026

Last changed: December 18, 2007

kmccrea@sabl原因.com; keith.brown@swgas.com; francisco.aguilar@swgas.com; mthorp@sempra.com; dhuard@manatt.com; wlack@elllaw.com; npedersen@hanmor.com; brad@bblsurflaw.com; klatt@energyattorney.com; klatt@energyattorney.com; douglas.porter@sce.com; burkee@cts.com; wtobin@sempraglobal.com; snelson@sempra.com; marcie.milner@shell.com; jleslie@luce.com; marcel@turn.org; mflorio@turn.org; dil@cpuc.ca.gov; edm@cpuc.ca.gov; map@cpuc.ca.gov; ek@a-klaw.com; rbm4@pge.com; jarmstrong@gmsr.com; edwardoneill@dwt.com; tomb@crossborderenergy.com; glw@eslawfirm.com; steve.williams@swgas.com; valerie.ontiveroz@swgas.com; HYao@SempraUtilities.com; bmusich@semprautilities.com; centralfiles@semprautilities.com; rcavalleri@semprautilities.com; rkeen@manatt.com; nwhang@manatt.com; asteele@hanmor.com; Case.Admin@sce.com; Jairam.gopal@sce.com; michael.alexander@sce.com; ygross@sempraglobal.com; liddell@energyattorney.com; bruce.foster@sce.com; pvillegas@semprautilities.com; filings@a-klaw.com; sls@a-klaw.com; kjbh@pge.com; lcr0@pge.com; MEkd@pge.com; mmattes@nossaman.com; suzannetoller@dwt.com; pthompson@summitblue.com; ceyap@earthlink.net; mrw@mrwassoc.com; jdheslawfirm.com; egw@a-klaw.com; alf@cpuc.ca.gov; pzs@cpuc.ca.gov; rxr@cpuc.ca.gov; rmp@cpuc.ca.gov; trp@cpuc.ca.gov; mbm@brianmcmahonlaw.com; marywong@semprautilities.com; rruiz@sempra.com;

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing NOTICE OF EX PARTE COMMUNICATION on all known interested parties of record in A.06-08-026 by electronic mail, and by U.S. mail to those without an email address.

Dated at Los Angeles, California this 11th day of March, 2008.

/s/ Rose Mary Ruiz

Rose Mary Ruiz

CALIFORNIA PUBLIC UTILITIES COMMISSION Service Lists - Proceeding: A0608026 Last changed: February 15, 2008

keith.mccrea@sabl原因.com; francisco.aguilar@swgas.com; keith.brown@swgas.com; mthorp@sempra.com; dhuard@manatt.com; wlack@elllaw.com; npedersen@hanmor.com; brad@bblsurflaw.com; klatt@energyattorney.com; klatt@energyattorney.com; douglas.porter@sce.com; burkee@cts.com; wtobin@sempraglobal.com; snelson@sempra.com; marcie.milner@shell.com; jleslie@luce.com; marcel@turn.org; mzafar@semprautilities.com; mflorio@turn.org; dil@cpuc.ca.gov; edm@cpuc.ca.gov; map@cpuc.ca.gov; ek@a-klaw.com; rbm4@pge.com; jarmstrong@gmssr.com; edwardoneill@dwt.com; tomb@crossborderenergy.com; glw@eslawfirm.com; steve.williams@swgas.com; valerie.ontiveroz@swgas.com; ghealy@semprautilities.com; HYao@SempraUtilities.com; bmusich@semprautilities.com; centralfiles@semprautilities.com; rcavalleri@semprautilities.com; rkeen@manatt.com; nwhang@manatt.com; asteeler@hanmor.com; Case.Admin@sce.com; Jairam.gopal@sce.com; michael.alexander@sce.com; ygross@sempraglobal.com; liddell@energyattorney.com; bruce.foster@sce.com; pvillegas@semprautilities.com; filings@a-klaw.com; sls@a-klaw.com; kjbh@pge.com; MEkd@pge.com; mmattes@nossaman.com; suzannetoller@dwt.com; RegRelCPUCcases@pge.com; pthompson@summitblue.com; ceyap@earthlink.net; mrw@mrwassoc.com; jdh@eslawfirm.com; egw@a-klaw.com; alf@cpuc.ca.gov; pzs@cpuc.ca.gov; rxr@cpuc.ca.gov; rmp@cpuc.ca.gov; trp@cpuc.ca.gov; mbm@brianmcmahonlaw.com; marywong@semprautilities.com; rruiz@sempra.com;